

ANALYSIS OF AMENDED BILL

Franchise Tax Board

Author: Polanco Analyst: Colin Stevens Bill Number: SB 1873
Related Bills: AB 3117 (1995/96)
AB 1413 (1997/98) Telephone: 845-3036 Amended Date: 8/26/98
Attorney: Doug Bramhall Sponsor: CA Credit Union League

SUBJECT: Exempt Corporations/Adds Credit Unions

SUMMARY OF BILL

This bill would allow state-chartered credit unions to qualify for exemption from franchise or income tax under the Bank and Corporation Tax Law (B&CTL) and also would exempt all credit unions from other state, county and municipal taxes and license fees, except certain specified taxes.

SUMMARY OF AMENDMENT

The August 26, 1998, amendment made a minor technical change to terms.

The August 25, 1998, amendment removed the prior provisions of the bill relating to a tax credit for vehicle license fees and inserted the provisions discussed in this analysis.

EFFECTIVE DATE

This bill's provisions would apply to income years beginning on or after January 1, 1998.

BACKGROUND

CREDIT UNIONS

Credit unions are defined under the California Financial Code as a cooperative, organized for the purposes of (1) promoting thrift and savings among its members, (2) creating a source of credit for their members at rates of interest set by the board of directors, and (3) providing an opportunity for members to use and control their own money on a democratic basis in order to improve their economic and social conditions. As a cooperative, a credit union conducts its business for the mutual benefit and general welfare of its members with the earnings, savings, benefits, or services of the credit union being distributed to its members as patrons.

To qualify as a state-chartered credit union, the organization must meet certain statutory requirements and must apply for and receive a certification from the California Commissioner of Corporations.

Under federal law, a federally-chartered credit union is a cooperative association organized under the Federal Credit Union Act and granted a certificate of status by the National Credit Union Administration (NCUA).

Board Position:

<u> </u> S	<u> </u> NA	<u> </u> NP
<u> </u> SA	<u> </u> O	<u> </u> NAR
<u> </u> N	<u> </u> OUA	<u> </u> X PENDING

Department Director

Date

Gerald H. Goldberg

9/15/98

A federally-chartered credit union generally is not taxable by states, except for taxes on real property and tangible personal property.

EXEMPT ORGANIZATIONS

The California Corporations Code governs the formation of corporations in California. A corporation may be incorporated as a "for profit" corporation or a "nonprofit" corporation. "For profit" corporations do not qualify for tax-exempt status. California nonprofit corporations are either public benefit corporations, mutual benefit corporations or religious corporations. Nonprofit corporations are not automatically exempt from taxation. A nonprofit corporation must apply for tax-exempt status with the FTB and receive a determination exempting the organization from state tax. A tax-exempt corporation incurs a tax liability on its taxable business income unrelated to its exempt purpose.

Federally chartered credit unions are generally not taxable under **federal or state law** by operation of the Federal Credit Union Act. Federal law also provides exemption from the federal income tax for nonprofit organizations that meet certain criteria. If an organization fails to meet those criteria, the Internal Revenue Service (IRS) may deny exempt status or may revoke the exempt status of an organization which no longer meets the criteria. Federal credit unions currently are eligible for federal tax-exempt status.

SPECIFIC FINDINGS

Under current law a state-chartered credit union is considered in substantial competition with national banks and is classified as a financial corporation for state tax purposes and is subject to the franchise tax. However, since credit unions are operated on a cooperative basis, they are allowed a deduction for all the income resulting from or arising out of business activities with their members, as defined, or on a nonprofit basis with nonmembers.

Current law defines "surplus member savings capital" as the savings capital of a credit union in excess of the savings capital which is lent to members of the credit union. Income from permitted investments of surplus member savings capital and from reciprocal transactions with member credit unions constitutes income "for or with members" and is deductible from taxable income. Remaining investment income is subject to taxation.

While state chartered credit unions are subject to the franchise tax for state purposes, no minimum tax is imposed (unlike other corporations which must pay a minimum franchise tax of \$800, regardless of income or loss). As a financial corporation, credit unions are subject to the tax rate imposed on banks and other financial corporations, currently set at the franchise tax rate plus 2%.

Under both state and federal law tax-exempt organizations are taxable on their "unrelated business taxable income" (UBTI). UBTI is the gross income derived from any trade or business unrelated to the organization's tax-exempt purpose less directly connected allowable deductions. In addition, income that is attributable to property acquired through debt financing constitutes UBTI, as does certain advertising and insurance income.

SB 1873 would exempt state-chartered credit unions from the income or franchise tax, (including the in-lieu rate) under the B&CTL and also would exempt all credit unions from other state, county and municipal taxes and license fees, except certain specified taxes such as sales and use taxes, taxes on unrelated business income, and motor vehicle license fees. Thus, under this bill, state-chartered credit unions would be exempt from the income and franchise taxes (including the in-lieu rate), and county and municipal taxes and license fees, but would be subject to tax on UBTI. However, income earned on investments of surplus member savings capital generally would not be subject to tax on UBTI because it is not debt-financed income.

Policy Considerations

This bill would place state credit unions on a more equal footing with federal credit unions, which generally are exempt from state tax.

Credit unions are financial organizations that compete with other types of financial organization (e.g., banks, saving and loan organizations, thrift associations, etc.), which are subject to California tax. By exempting credit unions from franchise tax and income tax, this bill would provide different tax treatment for various financial organizations.

Implementation Considerations

Implementation of this bill would not significantly impact the department's programs and operations.

Technical Consideration

This bill fails to repeal provisions in Section 24405 dealing with credit unions. The author's intention for retaining these provisions is unclear and could lead to disputes as to applicable law.

On the other hand, this bill would exempt credit unions from a variety of unidentified taxes, which would be referenced in the B&CTL even though these taxes are not administered by the Franchise Tax Board. These exemptions would be more properly located under other provisions of state law.

FISCAL IMPACT

Departmental Costs

This bill would have a minor impact on the department's cost of operation.

Tax Revenue Estimate

This bill would result in estimated revenue losses under the B&CTL as shown in the table below:

Estimated Revenue Impact of SB 1873 As Amended 8/25/98 [\$ In Millions]		
1998-99	1999-00	2000-01
(\$1)	(\$1)	(\$1)

The bill would be effective income years beginning on or after January 1, 1998.

This analysis does not consider the possible changes in employment, personal income, or gross state product that could result from this measure.

Tax Revenue Discussion

The revenue impact of this bill would be determined by the reduction in self-assessed and audit assessed franchise taxes (including those attributable to the in-lieu rate) paid by state-chartered credit unions.

The estimate is based on state tax return data. For nearly all state-chartered credit unions, self-assessed taxes and any additional taxes assessed through audit were summed. For the 1993 income year, the tax totaled \$750,000.

As exempt organizations under this proposal, credit unions would be subject to unrelated business income tax (UBIT). However, it is unlikely credit unions would have any significant unrelated business income. Any tax revenue that might be derived from UBIT is unknown but would be very minor.

BOARD POSITION

Pending.